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Linking governance to efficacy of corporate boards: a global perspective

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Abstract

Efficacy of corporate boards and its determinants has been subject to so many interdisciplinary studies in the scholarship literature. The aim of this research paper is to empirically investigate through a cross-country analysis the effects of country-level governance on governance at corporate level. For measuring the country-level governance, there were selected the governance indicators developed by World Bank based on methodology of Kaufmann (1999a,b), while for the dimensioning the corporate governance it was selected the efficacy of corporate boards. For the goal of the paper, a multiple regression analysis was performed, by employing the SPSS statistical packaged software, so that, to be able to assess the effects of quality of governance at country-level on corporate governance for a large sample of countries. By performing this empirical analysis from both geographical and income group's classifications, there are some differences arising between different geographical regions, but also between various income groups. Even so, for countries from Europe and North and Central America, but also for countries classified as high-level incomes and members OECD, the findings confirm that there are strong positive correlations between most of the World Bank' s governance clusters and efficacy of corporate boards.

Keywords: efficacy of corporate boards, country-level governance, cross-country analysis, corporate governance, high income OECD

1. Introduction

The academic literature focusing on the boards of directors has increased rapidly, especially in the last decades, in the light of the financial scandals that seriously affected some of the advanced economies. This growing interest for the efficacy of corporate boards is well argued, especially if we consider the statement of Francis et al. (2012), according to *"corporate boards are one of the, if not the most important internal corporate governance mechanisms that monitor and advice management in fulfilling the mandate to protect shareholder interests"* (this opinion being also shared by other researchers such as Coles et al., 2008; Adams and Ferrera, 2007; Perry and Peyer, 2005; Ferris et al., 2003; Baghat et al., 1999; Hermalin and Weisbach, 1998, 2003; Agrawal and Ferreira, 2009; John and Senbet, 1997; Fama and Jensen, 1983; Jensen and Meckling, 1976).

Good governance at country-level it is highlighted by scholarship literature as being one of determinants factor for the business environment. As Çule and Fulton (2013) state the impact of governance over the business framework is

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given by the assumption that an economy with a moderate level of bureaucracy, a high level or preoccupation for legislative compliance and effective instruments for controlling the corruption is expected to create and maintain a business environment that stimulate economic performance. In the same vein, Price *et al.* (2011) argues that many governance studies have truly proved the influence of global governance on performance and transparency, which finally influences the stimulation of the business environment's competitiveness.

In this wide context of analysis, our aim is to bring into discussion how and to what extent good governance at country-level could significantly influence the key driver of corporate governance, namely, the corporate board and its effectiveness. This research objective is also supported by the idea that this topic – efficacy of corporate boards – is one of great interest and concern for both scholarships and policy and regulators makers, because of its complexity, and therefore the need to approach this subject from various perspectives is obviously. Without claiming to provide answers to all questions, another goal of this paper is to set a stage for discussion for investigation of the potential linkage between global governance and corporate governance along with its central mechanisms.

This paper intends to provide a contribution to the literature by presenting, discussing and highlighting the potential influence that global governance features captured through some relevant indicators might have on efficacy of corporate boards, based on data and variables computed within the reports issued by world-wide recognized professional organizations such as World Bank and World Economic Forum. The paper proceeds as it follows. Next section provides a selection of most relevant findings of the background literature; hence reaching our main research question *"Does country-level governance influence the efficacy of corporate boards as a proxy of corporate governance?"* Starting from this research question we issued the research hypothesis. After presenting in Section 3 in detail the research methodology used, variables and data sources employed for achieving the scientific objective proposed, we test our hypothesis and the results of our empirical investigation are presented within Section 4. The paper ends with Section 5 summarizing the main conclusions.

2. Literature Review And Hypotheses Development

2.1. Board performance – a key driver of corporate governance

The board of directors is one of the central corporate governance mechanisms, while it is perceived as a main instrument for shareholders to keep under control the top management (John and Senbet, 1997). There is a large amount of research papers, many of them adopting an empirical research, bringing into discussion following issues: the effectiveness of corporate boards in achieving its monitoring function; the influence of corporate boards on firms performance and value; the composition of boards of directors and its impact on firm performance; the interaction between corporate boards and management; the role of corporate boards in firms performance during financial crisis; the impact of board characteristics on board efficacy and firm performance.

Many of the studies dedicated to this issue were most dedicated to the empirical analysis of the relationship between corporate boards and corporate performance, especially focusing on the connections that might be identified between various features of corporate board, managerial ownership and firm performance, while the researchers employed different research methods in order to face the endogeneity that arises when corporate board structure and characteristics are linked to firm performance (Ferrero-Ferrero et al., 2012; Adams and Ferreira, 2009; Baghat and Bolton, 2008; Guner et al., 2008; Manjon, 2007; Gugler and Weigand, 2003; Hermalin and Weisbach, 2003; Bhagat and Black, 2001).

Analyzing the influencing factors on board activity and its effectiveness, Vafeas (1999) and Adams (2005) cited by Brick and Chidambaran (2010) state that an important determinant of board activity is firm performance, because poor performance may impose a greater pressure on corporate boards. Also, it is highlighted the advising role of the corporate boards that should provide effective advices about the ways of increasing the value of investments for the firms. According to Raheja (2005), the independence of the directors on the board it is perceived as an important influencing factor on board activity. Brick and Chidambaran (2010) argue that prior firm performance, firm characteristics and governance characteristics are determinant factors for the board activity, while board activity has a positive impact on firm value. Also, prior studies (Adams and Ferreira, 2009; Guner et al., 2008; Perry and

Shivdasani, 2005; Shivdasani and Yermack, 1999) analyzed the relationship between board's characteristics such as board size, board duality, board shareholdings and board efficacy and firm performance, while Francis et al. (2012) extend the conclusions of prior studies, concluding that the impact of efficacy of corporate boards on firm performance is more evident during the economic crisis period than before the crisis period. On the other hand, only few papers such as Mitton (2002), Johnson et al., (2000) analyzed the impact of country-level legal protection and firm-level disclosure quality on efficacy of corporate boards and firm performance.

From our knowledge, the prior research studies focused on analyzing the determining factors on efficacy of corporate boards are more concentrated on the influence of internal and external corporate governance mechanisms, while the influence of mechanisms of country-level governance was too less analyzed. Therefore, one major interest in developing such a paper was to provide a new perspective, a more global one, from which the efficacy of corporate boards should also be analyzed.

2.2. Conceptual approaches of country-level governance

In the last decades, the concept of governance has been widely discussed and analyzed within the academic literature and not only along with its various influences on development outcomes. The concept of governance has known many approaches and definitions during time, but *"no one of them can claim ownership of the ultimate definition of governance"* (Kardos, 2012). As Ivan (2008) states *"governance"* was borrowed from the culture of companies that wish to lead to an increased efficiency through improving the systems of principles and practices that the company was managed. On other hand, Bundschuh-Rieseneder (2008) defines this concept as being *"the favorable political framework conditions for social, ecological and market oriented development as well the responsible use of political power and public resources by the state"*.

Governance is approached as a neutral concept by World Bank in its working paper *"Governance and Economy: a review"*, citing from Random House College Dictionary (1984, p.571), where this concept is defined as *"the political direction and control exercised over the actions of the members, citizens or inhabitants of communities, societies and states"* (World Bank, 'Governance and economy: a review', 1991). It is obviously that this concept is a controversial one, being a large amount of papers and reports that have provided many definitions of governance. But according to Kaufmann and Kraay (2008), in spite of the diversity of the definitions assigned to this term, still there should be a consensus about the essence of good governance, starting from the idea that many of these approaches have a common element that governance should express "*the importance of a capable state operating under the rule of law*".

In the light of the above prior mentioned research papers in this area, but also considering the purpose of this paper, we argue that governance at country-level positively influences the corporate governance captured through the efficacy of corporate boards and propose the following research hypothesis:

H_0. All six World Bank governance indicators (1.Voice and Accountability; 2. Political Stability and absence of violence; 3.Government effectiveness; 4.Regulatory Quality; 5. Rule of Law; 6. Control of Corruption) have a positive impact on efficacy of corporate boards.

3. Research Design

3.1. Research goal

The purpose of this paper is to explore the potential linkage that could be identified between quality of governance at country-level measured through some relevant indicators and efficacy of corporate boards, following to develop this empirical investigation from both geographical and income groups classifications. The empirical analysis was realized by employing the SPSS statistical packet program through multiple regression analysis, while information from three major datasets has been used, in order to provide empirical evidence that might validate or invalidate the above established hypothesis.

3.2. Sample and Data Collection

Considering the arguments presented above, in spite of critics and weaknesses that could be assigned to the World Bank' s system of governance indicators, our decision was to used all these six indicators of good governance (*Voice and Accountability; Political Stability and absence of violence; Government effectiveness; Regulatory Quality; Rule of Law; and Control of corruption*) as they are dimensioned within the World Bank report *"The Worldwide Governance Indicators",* for more than 200 world-wide economies, based on information provided by more than 40 data sources produced by over 30 various organizations worldwide.

Second dataset used in our survey was given by the ranking computed for the corporate governance of each country sampled, captured through the **efficacy of corporate boards** as it is measured within the report *"Global Competitiveness Report"* issued by World Economic Forum. First version if this report was issued in 2004 (Sala-i-Martin and Artadi, 2004) and nowadays this report is appreciated as being one of the most comprehensive evaluation reports designed to measure the global competitiveness. The global competitiveness indicator is global one, which contains approximately 115 variables and 12 pillars grouped on three sub-indexes. The variable - **efficacy of corporate boards** – used in our study is a component of the 1st pillar *Institutions* referring to the accountability of the private institutions, along with other variables such as strength of auditing and reporting standards or strength of investors protection.

Finally, the last dataset used in our survey was given by the World Bank report "*Country and Lending Groups*" issued in July 2012, where all economies of all countries with population of more than 30,000 citizens are divided on income groups, according to the main criterion the gross national income (GNI) per capita, using the World Bank Atlas methodology. The main categories of income groups as they are defined by World Bank are: low income ($1,025 or less), lower middle income ($1,026 - $4,035), upper middle income ($4,036 - $12,475), high income ($12,476 or more, classified also in non-OECD and OECD members). The classification used in our study was the one given by the last version of this report issued on July 1, 2012, 2012 which is available until 1 July 2013. Starting from the availability of the data for the period analyzed (2011 year), the final sample employed in our study consists of 144 countries, and below Table 1 summarizes all data sources and variables used for designing this study.

Table 1. Variables and data sources employed in this study

Variable Name	Type of variable	Source	Description	No. of countries
1.Voice and accountability *2.Political Stability and Absence of Violence* *3.Government effectiveness* *4.Regulatory quality* *5.Rule of law* *6.Control of corruption*	Independent variables	Worldwide Governance Indicators (WGI) project 1996-2011	It ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance)	215 countries
Efficacy of corporate boards	Dependent variable	World Competitiveness Report 2012-2013	It ranges from approximately from 1 = management has little accountability to investors and boards to 7 = investors and boards exerts strong supervision of management decisions	144 countries

4. Empirical results

Starting from all these datasets mention in the section above, the final sample of countries for achieving the scientific objective of this cross-country investigation included 144 countries, for which all necessary data was available in all referenced reports. In order to validate or to invalidate the research hypothesis proposed above, a multiple regression analysis was conducted from the perspective of both geographical regions and classification of world economies on income categories. Thus, the results of multiple regression analysis from the perspective of geographical regions are disclosed within Table 2 and 3, when efficacy of corporate boards as a dependent variable is regressed, one at a time, on each of the independent variables given by all six governance indicators.

When we examined Table 2 and 3, it can be noticed that relevant differences emerge between African countries and the other continents like Europe and North America, when the scoring assigned to the efficacy of corporate boards is regressed on each of the six governance indicators, one at a time. From statistical point of view, from all governance dimensions considered, only *'Regulator quality'* is globally proved as having a relevant influence on the efficacy of corporate boards. This indicator expressed estimates over the influences of the policies or excessive regulation which could have an impact on business environment.

Also, governance clusters like *'Government effectiveness', 'Rule of law'* and '*Control of corruption',* who expressed the respect of the citizens and the state for the rules and for the public institutions that govern economic and social interaction between them are, also, proved to be statistically significant for almost all regions, except for countries from Africa regions. Considering the major proportion of developing countries in Africa, these results are supported by the results of previous studies (Bardhan, 2002; Gani and Duncan, 2007) which conclude that instruments and mechanisms for monitoring the performance of the public services and the compliance with rules are much weaker for such developing countries. On the other hand, the first two indicators who evaluate the fairness of the process by which governments are selected and replaced like '*Voice and accountability'* and '*Political Stability'* seems to contribute at the explaining of the variance of efficacy of corporate boards only for countries from Europe and North and Central America.

Table 2. Regression of the efficacy of corporate boards on first three governance indicators – *geographical regions*

Continent	Voice and accountability			Political Stability			Government effectiveness		
	(Constant)	Slope	R Square	(Constant)	Slope	R Square	(Constant)	Slope	R Square
Europe	4,032	0,638	**0,407**	4,267	0,583	**0,363**	4,169	0,494	**0,501**
	(30,859)*	(5,262)		(39,715)*	(4,526)		(41,797)*	(6,016)	
North and Central America	4,409	0,501	**0,251**	4,550	0,581	**0,525**	4,543	0,389	**0,542**
	(46,716)*	(3,727)		(53,749)*	(3,787)		(54,632)*	(3,922)	
South America	4,262	0,446	0,199	4,416	0,243	0,181	4,387	0,468	**0,537**
	(38,017)	(2,432)		(30,505)	(1,332)		(44,227)*	(3,049)	
Africa	4,476	0,136	0,019	4,507	0,225	0,120	4,598	0,331	0,112
	(43,939)	(1,066)		(49,296)	(2,155)		(38,385)	(2,070)	
Asia	4,516	0,061	0,004	4,602	0,316	**0,360**	4,437	0,431	**0,451**
	(42,824)	(0,512)		(62,706)*	(4,565)		(69,071)*	(5,515)	

Note: Number in parentheses are *t*-statistics; *statistically significant at 1% level.
Source: Own calculations based on the datasets presented above

Table 3. Regression of the efficacy of corporate boards on last three governance indicators – *geographical regions*

Continent	Regulatory quality			Rule of low			Control of corruption		
	(Constant)	Slope	R Square	(Constant)	Slope	R Square	(Constant)	Slope	R Square
Europe	3,985	0,653	**0,518**	4,155	0,515	**0,555**	4,247	0,459	**0,608**
	(33,172)*	(6,216)		(44,550)*	(6,701)		(54,747)*	(7,476)	
North and Central America	4,393	0,514	**0,587**	4,616	0,413	**0,697**	4,590	0,456	**0,742**
	(49,983)*	(4,298)		(67,563)*	(5,468)		(73,400)*	(6,113)	
South America	4,387	0,413	**0,751**	4,476	0,370	**0,603**	4,367	0,337	**0,498**
	(60,605)*	(4,913)		(44,988)*	(3,488)		(42,661)*	(2,815)	
Africa	4,595	0,385	**0,154**	4,535	0,221	0,060	4,490	0,165	0,033
	(42,830)*	(2,487)		(39,059)	(1,472)		(41,135)	(1,074)	
Asia	4,450	0,392	**0,342**	4,517	0,420	**0,425**	4,553	0,391	**0,426**
	(63,438)*	(4,382)		(69,028)*	(5,230)		(68,599)*	(5,244)	

Note: Number in parentheses are *t*-statistics; *statistically significant at 1% level.
Source: Own calculations based on the datasets presented above

Employing multiple regression analysis and considering the same variables, but from the perspective of income groups classification, as it is defined by World Bank, the results are displayed within Table 4 and 5. From statistically point of view, the influence of governance indicators on efficacy of corporate boards, when multiple regressions is applied from the perspective of income groups classification is felt differently and strong differences emerge between countries from '*High income: OECD'* category and the others income categories. For countries from '*Upper middle income*' it is also emphasized an influence of five of the six governance dimensions considered, even if this influence is not so great as for countries from '*High income: OECD'* category. Considering the significant proportion of countries from Europe and Central and North America included in the '*High income: OECD'* category, the results obtained could be correlated with the ones generated when the multiple regression analysis was performed from the geographical perspective.

Table 4. Regression of the efficacy of corporate boards on first three governance indicators – *income group classification*

Income category	Voice and accountability			Political Stability			Government effectiveness		
	(Constant)	Slope	R Square	(Constant)	Slope	R Square	(Constant)	Slope	R Square
Low income	4,262	-0,076	0,008	4,518	0,263	0,154	4,624	0,391	0,127
	(30,781)	(-0,446)		(36,178)	(2,090)		(25,097)	(1,867)	
Lower middle income	4,305	0,053	0,005	4,331	0,085	0,025	4,398	0,236	0,056
	(46,658)	(0,386)		(45,619)	(0,835)		(37,655)	(1,267)	
Upper middle income	4,419	0,225	0,127	4,459	0,286	**0,205**	4,405	0,488	**0,284**
	(63,196)	(2,355)		(65,259)*	(3,126)		(69,572)*	(3,885)	
High income: non OECD	4,709	-0,303	0,193	4,593	0,315	0,077	4,636	0,181	0,040
	(29,111)	(-1,697)		(18,433)	(1,004)		(17,524)	(0,706)	
High income: OECD	2,877	1,636	**0,668**	4,469	0,522	**0,240**	3,391	1,075	**0,788**
	(10,595)*	(7,632)		(26,472)*	(3,023)		(22,143)*	(10,371)	

Note: Number in parentheses are *t*-statistics; *statistically significant at 1% level.
Source: Own calculations based on the datasets presented above

Table 5. Regression of the efficacy of corporate boards on last three governance indicators – *income group classification*

Income category	Regulatory quality			Rule of low			Control of corruption		
	(Constant)	Slope	R Square	(Constant)	Slope	R Square	(Constant)	Slope	R Square
Low income	4,469	0,244	0,059	4,504	0,225	0,048	4,507	0,261	0,064
	(29,551)	(1,228)		(23,431)	(1,103)		(26,043)	(1,276)	
Lower middle income	4,354	0,229	0,050	4,399	0,193	0,035	4,316	0,053	0,003
	(45,487)	(1,196)		(31,907)	(0,988)		(32,717)	(0,280)	
Upper middle income	4,391	0,339	**0,235**	4,473	0,405	**0,284**	4,471	0,336	**0,206**
	(66,829)*	(3,417)		(68,637)*	(3,882)		(64,630)*	(3,139)	
High income: non OECD	4,581	0,248	0,054	4,466	0,450	0,146	4,537	0,373	0,193
	(15,659)	(0,829)		(16,482)	(1,434)		(21,428)	(1,695)	
High income: OECD	3,329	1,178	**0,715**	3,367	1,090	**0,780**	3,988	0,668	**0,775**
	(17,307)*	(8,523)		(21,223)*	(10,152)		(38,431)*	(10,005)	

Note: Number in parentheses are *t*-statistics; *statistically significant at 1% level.
Source: Own calculations based on the datasets presented above

5. Conclusions

The empirical cross-country investigation presented above emphasized that most influencing governance characteristics on the efficacy of corporate boards are the ones that materialized the respect of the citizens and the state for the rules and for the public institutions that govern economic and social interaction between them, but also the influences of the policies or excessive regulation which might have an impact on business environment (*'Regulator quality', 'Government effectiveness', Rule of law', 'Control of corruption'*). Governance indicator such as '*Voice and accountability'* and *'Political stability'* were highlighted as being less significant for the efficacy of corporate boards, especially for countries from other regions than Europe and North and Central America, and also for countries from lower income groups.

Because the impact of governance indicators on the efficacy of corporate boards is felt differently by high income and upper middle income economies compared to low and lower income ones, the final conclusion of this study is that our findings could only partial validate the research hypothesis issued above, about the positive influence of governance dimensions on efficacy of corporate boards.

No doubt, a more extensive research is absolutely required to further investigate the impact of governance characteristics on efficacy of corporate boards. The outline of a potential solution for the enhancing of the efficacy of corporate boards is beyond the scope of this paper, but this research aims to advance some thoughts on a potential way forward, especially if we consider the influence of governance indicators on business investments. Considering the positive linkage that exist between some of the governance indicators and the efficacy of corporate boards, it is now clear more than ever that researches focused on influencing factors on efficacy of corporate boards should consider not only internal and external corporate governance mechanisms but also mechanisms of country governance which finally expresses the ability of state to govern as most effective as possible, looking for solutions and opportunities for the economy to develop for the society's general interest.

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